

## Internal Revenue Service

## Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:CORP:B06-PLR-133508-02**

Date:

**September 13, 2002**

Legend:

Distributing:

Controlled:

Date 1:

Date 2:

Date 3:

State A:

Distributing Sub 1:

Distributing Sub 2:

Distributing Sub 3:

Business A:

Business B:

Business C:

Business D:

Controlled Sub 1:

Controlled Sub 2:

Controlled Sub 3:

XXX:

YYY:

Dear \_\_\_\_\_ :

This letter responds to the June 17, 2002 request for rulings submitted by your representatives regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

## Summary of Facts

Distributing was incorporated on Date1 in State A. Distributing has two classes of stock: Class A common stock which has voting, dividends, and transferability rights; and Class B, Series II common stock which receives dividends, but is nonvoting and nontransferable. The Class B stock is held by certain employees and the deferred compensation trust custodian.

Distributing is a holding company which has three operating subsidiaries: Distributing Sub 1, Distributing Sub 2, and Distributing Sub 3. Distributing Sub 1 is engaged in Business A, Distributing Sub 2 in Business B, and Distributing Sub 3 in Business C. The financial information received indicates that Business A, Business B and Business C (as conducted by Distributing through Distributing Sub1, Distributing Sub 2 and Distributing Sub 3) each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing also owns Controlled, a holding company subsidiary, which was formed on Date 2 as part of the restructuring of Business D which was completed on Date 3. Business D is operated through several subsidiaries, three of which are now owned directly by Controlled. They are Controlled Sub 1 which designs and manufactures Business D's products; Controlled Sub 2 which directly and through three wholly owned subsidiaries distributes Controlled Sub1's products throughout North America; and Controlled Sub 3 which manufactures and distributes Business D's products internationally through the group's foreign subsidiaries. Several of the subsidiaries owned by Controlled Sub 3 were purchased within the five year period prior to the proposed distribution. Business D was restructured to facilitate global efficiencies and provide a unitary vision for the business. There were no changes in the operations of the companies and no gain or loss was recognized in whole or part as result of the restructuring. The financial information submitted on Business D indicates that through Controlled Sub 1 and Controlled Sub 2 it has gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Business D is engaged in an industry which has experienced an increase in product recalls, investigations of products by the Consumer Products Safety Commission, and litigation arising from alleged product malfunctions. As a result, the costs for liability insurance for the industry has increased substantially. Distributing maintains an umbrella insurance policy for coverage equal to the fair market value of Distributing and Controlled. Distributing has been advised by its insurance agent that if Distributing and Controlled are separated, it will be able to acquire a separate umbrella insurance policy for less than its separate fair market value while Controlled's umbrella insurance policy will be retained at its net worth. Based on the premium information provided by Distributing's insurance agent, the projected cost savings amounts to a greater than 2% reduction of the base period net income of Distributing's affiliated group (as defined by Rev. Proc. 96-30, section 2.04). Accordingly, Distributing

proposes the following transaction:

1. Prior to the transaction, Controlled will rename its authorized common stock as Class A common stock and will authorize the issuance of non voting Class B common stock with the same rights and restrictions as the Class B common stock of Distributing.
2. Prior to the distribution, Distributing will transfer to Controlled certain assets and liabilities attributable to Business D.
3. The Class A Shareholders of Distributing will receive XXX number of shares of Controlled Class A common stock in exchange for XXX number of Distributing Class A common stock, and then will receive pro rata YYY number of shares of Controlled Class A common stock with respect to their remaining YYY number of shares of Distributing Class A common stock.
4. The Class B common stockholders who are employees of Controlled or its subsidiaries will exchange their shares of Class B common stock in Distributing for Class B common stock in Controlled of equal value. The Class B shareholders of Distributing who are employees of Distributing or its subsidiaries will retain their Class B shares of common stock.
5. After the distribution, Controlled will elect a new separate board of directors. Other than joint participation in health benefits programs (premiums will be assessed to each company on an arm's length basis), there is not expected to be any continuing business transactions between the Distributing and Controlled.

The taxpayers have made the following representations in connection with the proposed transactions:

- A. No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- B. The aggregate fair market value of the Distributing and Controlled Class A common stock to be held by the Class A shareholders of Distributing immediately after the distribution will be equal to the fair market value of the Distributing Class A common stock held by those shareholders prior to the distribution.
- C. The employee shareholders of Controlled or its subsidiaries will surrender their Distributing Class B common stock in the transaction. The employee shareholders of Controlled or its subsidiaries will receive a number of

shares of Class B common stock of Controlled in equal value to the shares Class B common stock of Distributing surrendered.

- D. The fair market value of the Distributing Class B common stock to be retained by the Class B shareholders of Distributing who are employees of Distributing or its subsidiaries will be equal to their Class B Distributing shares immediately before the distribution.
- E. Immediately after the distribution, at least 90% of the fair market value of the gross assets of Distributing will consist of stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in section 355(b)(2). See section 3.04 of Rev. Proc. 77-37, 1977-2 C.B. 568-570.
- F. The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and with regard to such corporation, there has been no substantial operational changes since the date of the last financial statements submitted.
- G. Immediately after the distribution, at least 90% of the fair market value of the gross assets of Controlled will consist of stock and securities of controlled corporations that are engaged in the active conduct of a trade or business as defined in section 355(b)(2). See section 3.04 of Rev. Proc. 77-37, 1977-2 C.B. 568-570.
- H. The five years of financial information submitted on behalf of Controlled is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.
- I. The gross assets of the trades and business of each of the controlled subsidiaries of Distributing and Controlled which is being relied on to satisfy the active trade or business requirement of section 355(b), have a fair market value that is greater than 5 percent of the gross assets of such controlled corporation.
- J. Following the distribution, Distributing and Controlled will each continue the active conduct of its business through its controlled subsidiaries, independently and with its separate employees.
- K. The distribution of the stock of Controlled is carried out for the following business purpose: To obtain significant cost savings. The proposed distribution of Controlled creates a company operating in a single segment, Business D, outside of the affiliated group, thus containing the associated risk within Controlled. This will result in a significant reduction

of Distributing's insurance premiums. The distribution of the Controlled stock is motivated, in whole or substantial part, by this corporate business purpose.

- L. There is no plan or intention by the shareholders or security holders of Distributing to sell, exchange, or otherwise dispose of any of their stock in, or securities of, Distributing or Controlled after the transaction.
- M. There is no plan or intention by either Distributing or Controlled, directly or indirectly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other through stock purchases meeting the requirements of section 4.05 (1)(b) of Rev. Proc. 96-30.
- N. There is no plan or intention to liquidate either Distributing or Controlled, to merge Distributing or Controlled with any other corporation, or to sell or otherwise dispose of the assets of Distributing or Controlled after the transaction, except in the ordinary course of business.
- O. The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by controlled plus any liabilities to which the transferred assets are subject; and the liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets and or employees being transferred.
- P. None of the property transferred from Distributing to Controlled is property with respect to which any investment credit under section 46 has been ,or will be claimed or with respect to which any investment credit is required to be captured.
- Q. Distributing neither accumulated its receivables nor made any extraordinary payment of its payables in anticipation of the proposed transaction.
- R. No intercorporate debt will exist between Distributing and Controlled subsequent to the Distribution of Controlled stock.
- S. Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see section 1.1502-13 and section 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect; section 1.1502-13 as published by T.D. 8597).

- T. Payments made in connection with all continuing transactions will be on an arm's length basis.
- U. Neither Distributing nor Controlled are investment companies as defined in section 368(a)(2)(f)(iii) and (iv).
- V. The distribution of Controlled is not part of a plan or series of related transactions (within the meaning of section 355(e)) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50% or more of the total combined voting power of all the classes of stock of Distributing or Controlled, or stock possessing 50% or more of the total value of all classes of stock of Distributing or Controlled.
- W. No Distributing shareholder or shareholders will hold immediately after the Distribution disqualified stock within the meaning of section 355(d)(3), which constitutes a 50 percent or greater interest in Distributing or Controlled. For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing stock that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution. For purposes of section 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock that was either (i) acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

## Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows:

1. The transfer of transferred assets to Controlled will be a reorganization under section 368(a)(1)(D). Distributing and Controlled will each be a party to the reorganization within the meaning of section 368(b).

2. Distributing will recognize no gain or loss on the transfer of the assets transferred to Controlled (section 361(a)).
3. Controlled will recognize no gain or loss on its receipt of the transferred assets (section 1032).
4. The basis of the assets received by Controlled will be the same as the basis of the assets in the hands of Distributing immediately prior to the transaction (section 362(b)).
5. The holding period of the assets transferred to Controlled will include the period during which such assets were held by Distributing (section 1223(2)).
6. No gain or loss will be recognized by (and no amount will be included in the income of) the Class A shareholders of Distributing upon the receipt of the Class A stock of Controlled (section 355(a)).
7. The aggregate basis of the Distributing and Controlled Class A stock in the hands of each Class A shareholder will equal the aggregate basis of the Distributing Class A stock held immediately before the distribution, allocated between the Distributing and Controlled stock in proportion to the relative fair market value of each immediately following the distribution (section 358(b)).
8. The holding period of the Controlled Class A stock received by a Distributing Class A shareholder will include the holding period of the Distributing Class A stock with respect to which the distribution will be made, provided that the Distributing Class A stock is held as a capital asset on the date of exchange (section 1223(1)).
9. Distributing will recognize no gain or loss on the distribution of the Controlled stock to the shareholders (section 361(c)),
10. No gain or loss will be recognized by (and no amount included in the income of) the Class B shareholders of Distributing who are employees of Business D upon the receipt of Class B stock of Controlled in exchange for Class B stock of Distributing (section 355 (a)).
11. The basis of the Controlled Class B stock received by a Distributing Class B shareholder will be the same as the basis of the Distributing Class B stock surrendered in the exchange (section 358(b)).
12. The holding period of the Controlled Class B stock received by a Distributing Class B shareholder will include the holding period of the

Distributing Class B stock surrendered in exchange, provided that the Distributing stock is held as a capital asset on the date of exchange (section 1223(1)).

13. Earnings and profits will be allocated between Distributing and Controlled in accordance with sections 312(h) and 1.312-10(a).

#### Caveats

We express no opinion on the federal income tax treatment of the proposed transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from the proposed transaction that are not specifically covered by the above rulings.

#### Procedural Statements

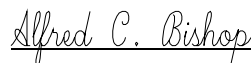
The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Each taxpayer involved in the transaction should attach a copy of this letter to the taxpayer's federal income tax return for the taxable year in which the transaction is completed.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,



Alfred C. Bishop  
Branch Chief, Branch 6  
Associate Chief Counsel (Corporate)